# 25 Years After the Asian Financial Crisis: What Have We Learned

Hoe Ee Khor, Chief Economist

NUS East Asian Institute Distinguished Public Lecture

July 21, 2022





#### **Outline of Presentation**

- Causes of the crisis
- Lessons of the crisis
- Reforms of the policy and regulatory framework at the individual country level
- Reforms of the international financial architecture
- New risks and challenges
- Future direction

### Once Upon a Time in Asia: Headline News Back in 1997



- "Thai Stocks Tumble as Baht Slides to Weakest in a Decade" (May 14, 1997)
- "Soros Led Attack on Baht, Says Thai Central Banker" (June 24)
- "Thai Currency Reserves Drop to \$33.3 Bln After Baht Defense" (June 26)
- "IMF, Japan, Others to Lend Thailand \$16 Billion" (Aug 12)
- "Thailand Closes 56 Finance Companies, Two to Reopen" (Dec 8)
- "Indonesia Floats the Rupiah; Currency Sinks 5%" (Aug 15, 1997)
- "Indonesia's Soedradjad Asks Banks to Cut Loans to Importers" (Aug 15)
- "Indonesia in Talks with IMF on Rupiah Collapse" (Oct 8)
- "Get out of Korea, Right Now!" (Nov 5, 1997; Peregrine Securities Report)
- "Korean President Apologizes to Nation for Seeking IMF Bailout" (Nov 22)
- "IMF Approves \$3.58 Bn Installment for South Korea" (Dec 19)
- "Korea, Thailand, Indonesia Ratings Cut to Junk by Moody's" (Dec 22)
- "Greenspan Blames Asian Policies for Currency Crisis" (Oct 14, 1997)
- "IMF's Camdessus Says Asian Fund Will Fail if IMF Impaired" (Nov 13)
- "Asia Bailout Fund Evolves toward Cooperative Facility" (Nov 18)

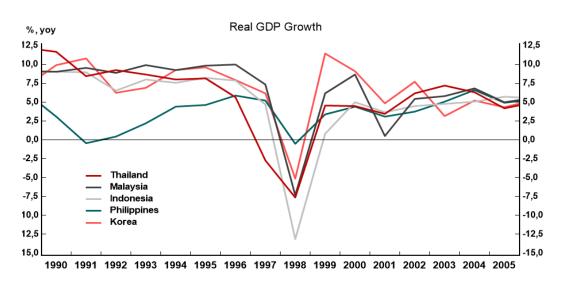


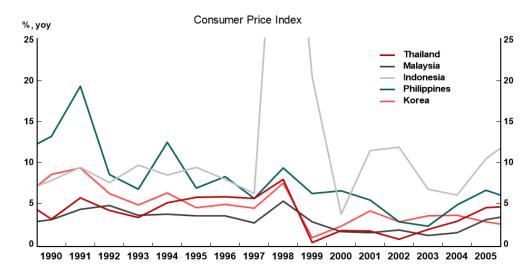
A South Korean labor union member of Seoul Bank, one of South Korea's most bad-debt burdened commercial banks, looks downcast. (Source: US Federal Reserve History)

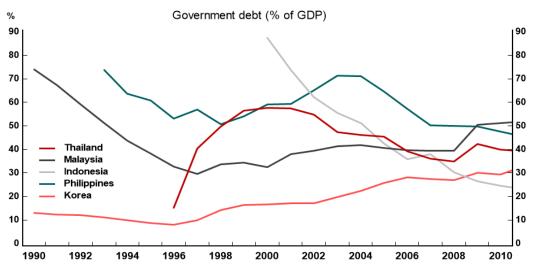
https://www.federalreservehistory.org/essays/asian-financial-crisis

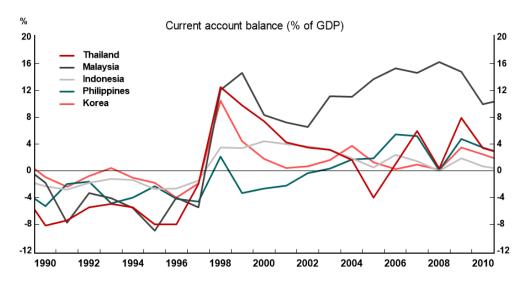
### ASEAN-4 and Korea: "Strong Fundamentals" prior to the AFC











### Causes of the Asian Financial Crisis (1)



The AFC was mainly caused by a combination of macroeconomic imbalances, external developments, and structural weakness in the financial and corporate sectors...

Excessive external lending and borrowing (original sin) Double mismatches (currency and maturity mismatch) Outdated policy and regulatory frameworks (pegged exchange rates and regulatory framework) Speculative attacks by macro hedge funds and herding behaviour Poor corporate governance (corruption, cronyism, and nepotism) Breakdown of the Bretton Woods system in 1971 and financial globalization

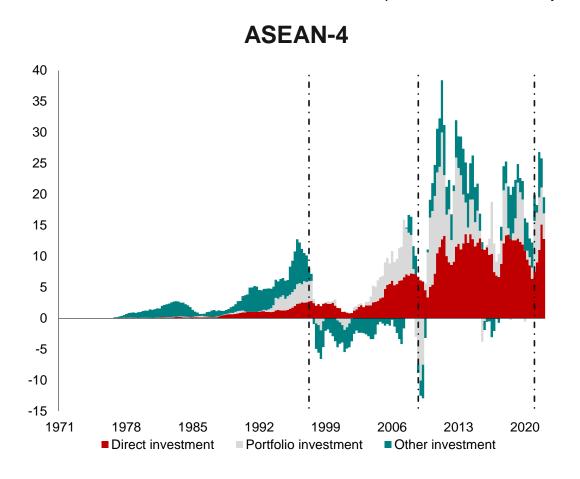
### Causes of the Asian Financial Crisis (2)

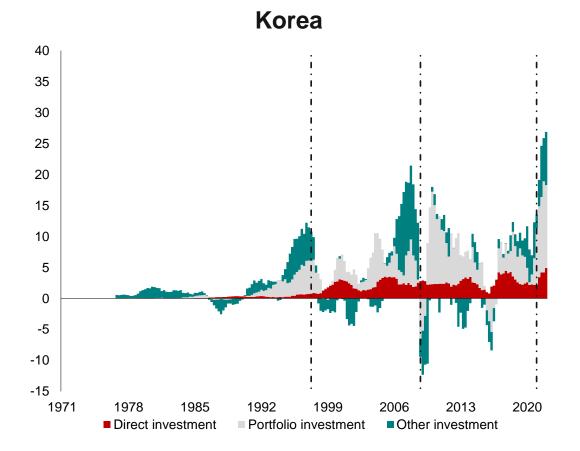


... amplified by sharp reversals in capital flows and market confidence (sudden stop).

#### **Selected ASEAN+3: Non-Resident Capital Flows**

(USD billion, 4-quarter moving average)



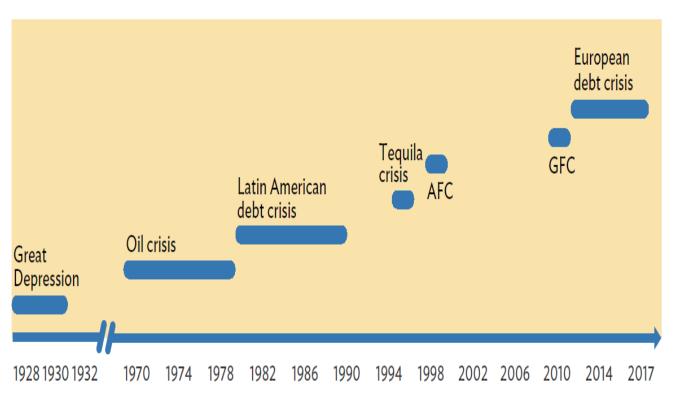


## Causes of the Asian Financial Crisis (3)

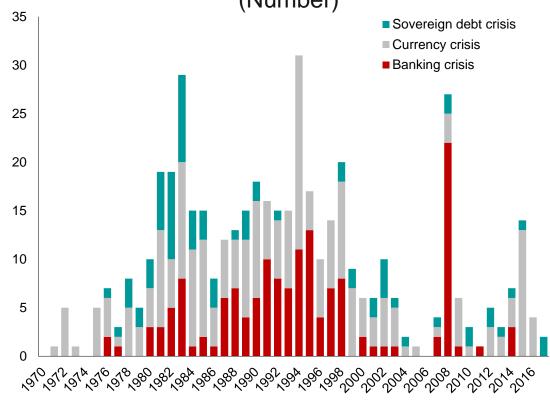


The poorly planned financial liberalization and premature capital account opening since the breakup of the Bretton Woods System in the early 1970s also contributed to the build-up of debt vulnerabilities in EMEs.

#### **Chronology of Financial Crises**



## Frequency of Financial Crises (Number)



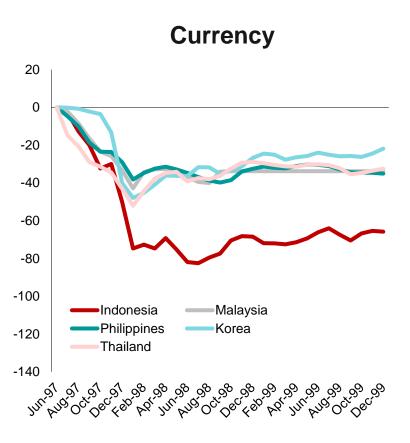
## Costs and scarring effects of the Asian Financial Crisis (1)

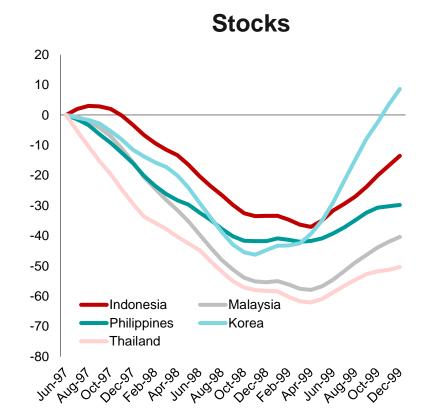


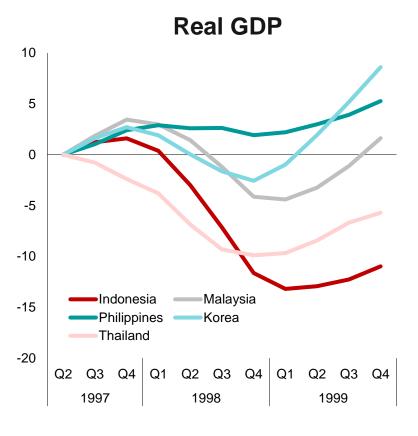
The AFC immediately triggered a sharp currency depreciation, a loss in investor confidence, and economic contraction.

#### Sudden Stop Contagion

(Cumulative percent change from June 1997)





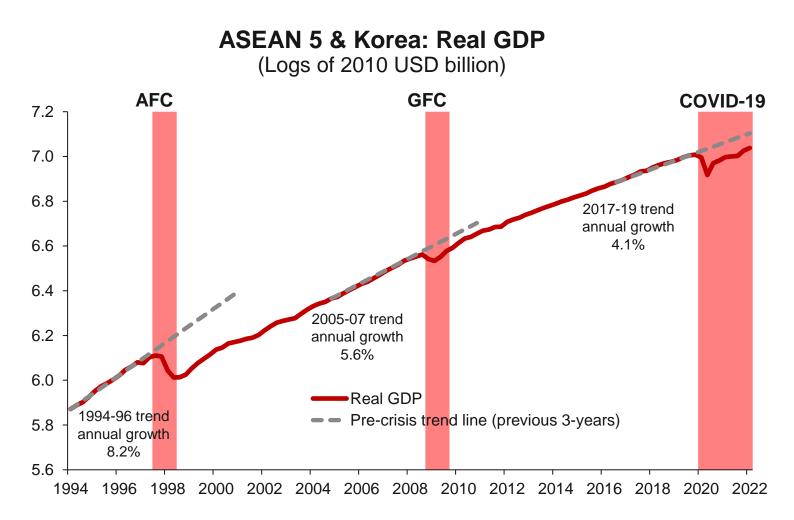


Sources: National authorities via Haver Analytics; and AMRO staff calculations.

## Costs and scarring effects of the Asian Financial Crisis (2)



while threatening the region's long-term economic growth.

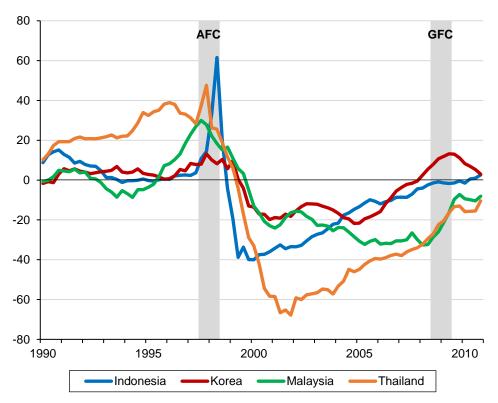


## Costs and scarring effects of the Asian Financial Crisis (3)



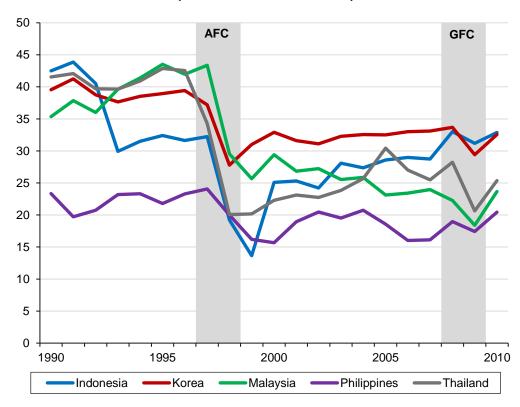
The crisis-hit countries were forced to go through a long period of deleveraging and the collapse of investment.

## Credit-to-GDP Gaps (Percent of GDP)



AFC = Asian financial crisis, GDP = gross domestic product, GFC = global financial crisis. Source: Bank for International Settlements.

## Domestic Investment (Percent of GDP)



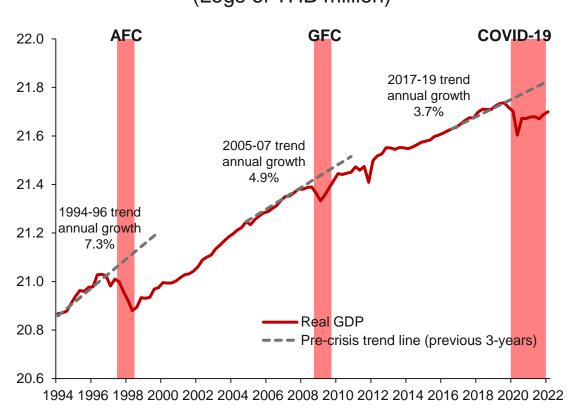
 $\mbox{AFC} = \mbox{Asian financial crisis, GDP} = \mbox{gross domestic product, GFC} = \mbox{global financial crisis.} \\ \mbox{Source: International Monetary Fund.}$ 

## Country case (1): Thailand

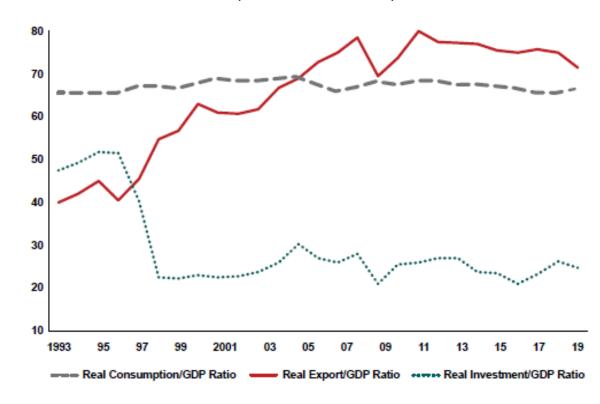


With the corporate sector's debt restructuring, investment declined substantially from the pre-crisis level, and contributed little to the post-crisis recovery.

## Thailand: Real GDP (Logs of THB million)



## Thailand: Post-Crisis Changes in Growth Driver (Percent of GDP)



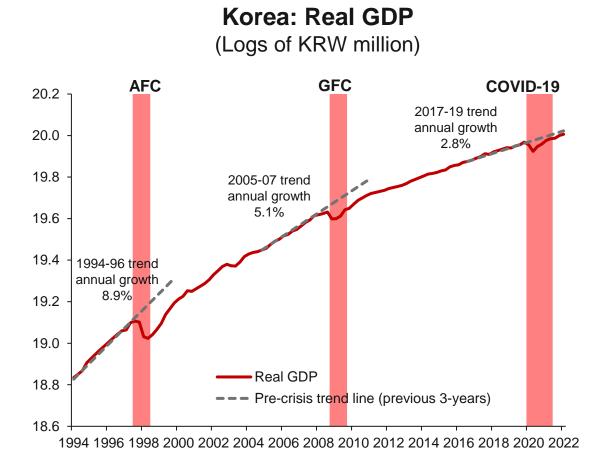
Sources: National authorities via Haver Analytics; and AMRO staff calculations...

Source: National Economic and Social Development Board; Chalongphob (2022) Chapter 14, "Trauma to Triumph – Rising from the Ashes of The Asian Financial Crisis"

## Country case (2): Korea

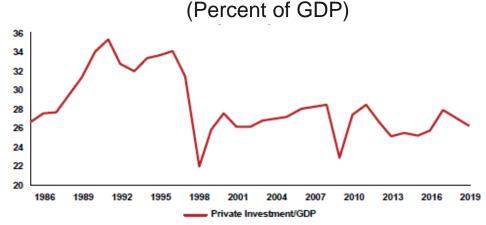


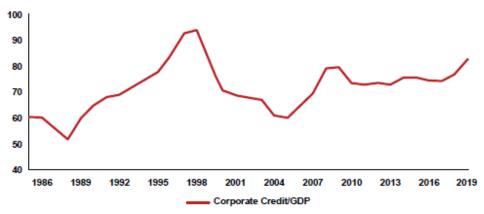
Chaebols' investment booms in 1994-1996, led by excessive leverage, was normalized with drastic debt restructuring and financial sector reforms in the post-AFC period.



Sources: National authorities via Haver Analytics; and AMRO staff calculations...

#### **Korea: Private Investment and Corporate Credit**





Source: Bank of Korea; Hahm and Kim (2022) Chapter 17, "Trauma to Triumph – Rising from the Ashes of The Asian Financial Crisis"

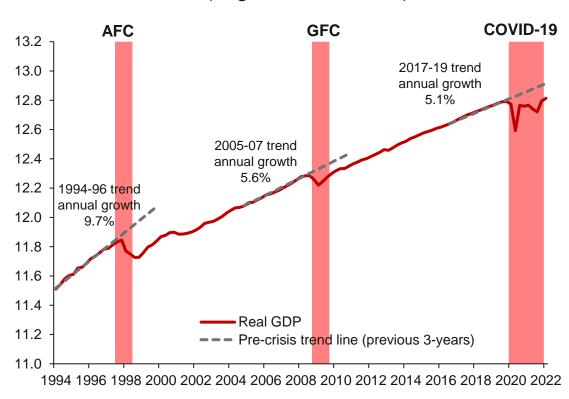
## Country case (3): Malaysia



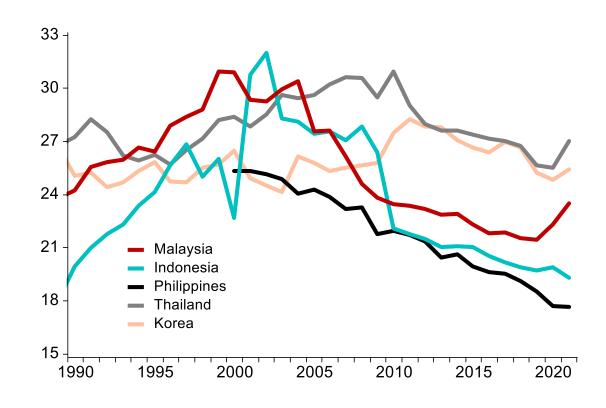
After the AFC, the decline in the manufacturing sector and exports led to the economy's greater dependence on the services sector and domestic demand, partly explaining a shift to a lower level of economic growth.

#### Malaysia: Real GDP

(Logs of MYR million)



## Crisis-hit Economies: Manufacturing Share of GDP (Percent of GDP)



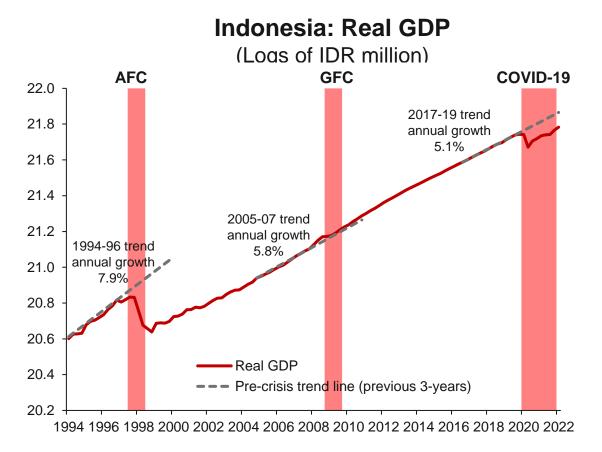
Sources: National authorities via Haver Analytics; and AMRO staff calculations.

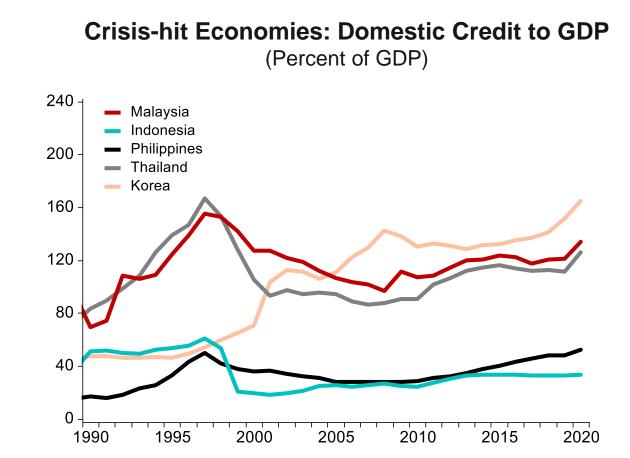
Source: World Bank via Haver Analytics

## Country case (4): Indonesia



The growth of credit and investment tumbled due to the restrictive macroeconomic policy, a disconnect between monetary policy and real sector, and the lure of higher returns from investing in financial assets.





### Lessons from the Asian Financial Crisis (1)



#### Handling Economic Challenges

Key lessons from the AFC

- Policymakers should pay more attention to the dynamics of cross-border capital flows and global financial markets
- Exchange rate should be more flexible and supported by ample reserves and policy buffers

Enhanced macrofinancial policy framework

- More disciplined monetary policy framework
- Fiscal consolidation to establish fiscal discipline
- Strengthening of the financial regulatory framework
- Better prudential oversight to deal with financial stability risks

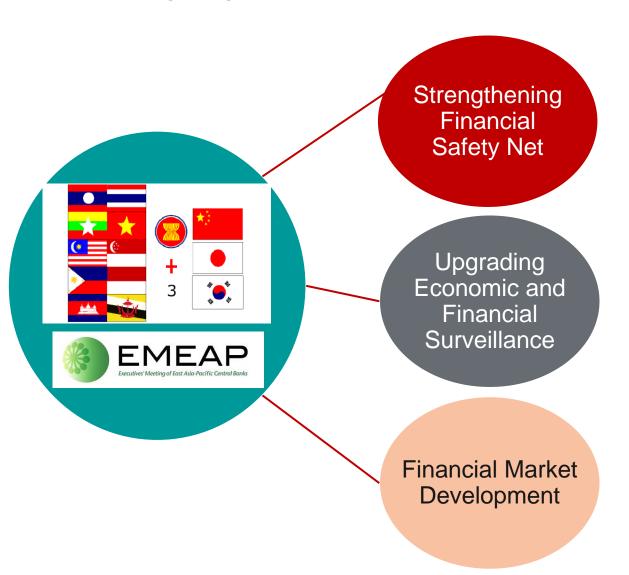
Strengthened economic fundamentals

- Economic growth momentum regained
- Financial health restored by repairing the balance sheets of corporates and banks
- Deleveraged and rebuilt fiscal space
- External position strengthened with a significant build-up in FX reserves

### Lessons from the Asian Financial Crisis (2)



#### Launching Regional Financial Cooperation



- Launch of **the CMI** at the ASEAN+3 FM Meeting (2000)
- Upgraded to the CMIM (2010), CMIM-SF totaling USD 120 billion (2010) and CMIM-PL doubling the size of the facility to USD 240 billion (2014)
- The IMF-delink portion raised from the initial 10% to 40% (2021)
- Launch of the Economic Review and Policy Dialogue (ERPD) process (May 2000)
- Establishment of AMRO as regional surveillance arm of the CMIM (Apr 2011)
- AMRO's official designation as an IO (Feb 2016)
- Launch of the Asian Bond Markets Initiative (ABMI) (Aug 2003)
- Creation of the Asian Bond Funds (ABF) under the initiative of EMEAP (Jun 2003)

## **Timeline of the Regional Financial Cooperation**



Asian financial crisis occurred in Thailand, Indonesia, and Korea.

ASEAN+3 finance ministers launched the Chiang Mai Initiative (CMI).

Global financial crisis occurred with the collapse of Lehman Brothers.

The CMIM Agreement came into effect.

- Size: **USD 120 bn**
- IMF De-Linked Portion (IDLP): **20%** of borrowing quota

The amended CMIM Agreement came into effect

- Doubling the size of the facility to **USD 240 bn**
- Raising IDLP from 20% to 30%
- Introducing a crisis prevention facility (CMIM Precautionary Line)

ASEAN+3 members completed the ratification of the AMRO Agreement

May 1999

May 2007

Feb 2009

Apr 2011

Feb 2016

Mar 2021

**Jul-Dec 1997** 

May 2000

**Sep 2008** 

Mar 2010

**July 2014** 

**Apr 2018** 

The first
ASEAN+3
Finance
Ministers'
Meeting was
held, aiming to
create a regional
financial facility.

ASEAN+3 agreed to strengthen the CMI into a single multilateralized arrangement, namely, the CMIM. ASEAN+3
Finance
Ministers
agreed to
establish an
independent
regional
surveillance
unit.

AMRO was established as a company in Singapore. The AMRO Agreement entered into force, establishing AMRO IO. The amended CMIM Agreement entered into force

- Increasing IDLP from 30% to 40%
- Institutionalizing LCY contributions for the CMIM crisis financing

## **Expanding ASEAN+3 Bilateral Swap Agreements (BSAs)**



Year	Amount (USD bn)				PBC- BI	PBC- HKMA			PBC- BOJ	PBC- BSP	JMOF BI	-JMOF- BSP	JMOF- BOT	JMOF- BNM	JMOF- MAS	BOJ- MAS	BOJ- BOT	BOK- BI	BOK- BSP	BOK- BNM	BI- MAS	BI- BNM
2009	82.0	•			•	•	•															
2010	108.4	•	•		•	•	•			•									•			
2011	168.7	•	•		•	•	•															
2012	188.6	•	•		•	•	•															
2013	222.5	•	•		•	•	•													•		
2014	175.2	•	•	•	•	•	•													•		
2015	171.4	•	•	•	•	•	•													•		
2016	172.2	•	•	•	•	•	•									•				•		
2017	250.3	•	•	•	•	•	•					•	•	•		•		•		•		
2018	333.0	•	•	•	•	•	•		•		•	•	•	•	•	•		•		•	•	
2019	323.7	•	•	•	•	•	•		•		•	•	•	•	•	•		•		•	•	•
2020	352.6	•	•	•	•	•	•	•	•		•	•	•	•	•	•	•	•		•	•	•
2021	371.6	•	•	•	•	•	•	•	•		•	•	•	•	•	•	•	•		•	•	•
2022	382.2	•	•	•	•	•	•	•	•		•	•	•	•	•	•	•	•		•	•	•

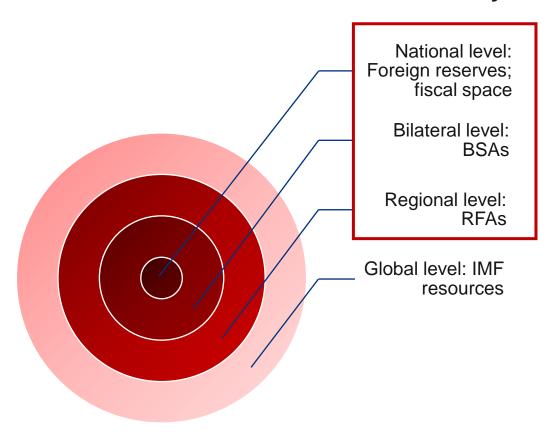
Sources: national authorities' website, as of March 2022; AMRO staff calculations

## Lessons from the Asian Financial Crisis (3)



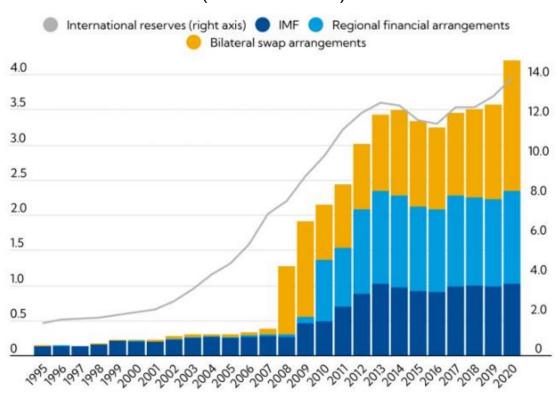
#### Sizing Up the Global Financial Safety Net

#### **Schematic of the Global Financial Safety Net**



Sources: ESM; IMF; and AMRO staff illustration.

## **Evolution of Global Financial Safety Net** (USD trillions)



Sources: M. Perks, Y. Rao, J. Shin, and K. Tokuoka (2021); US Federal Reserve website; RFA annual reports and press releases; and IMF staff calculations. For details see IMF Special Series note on COVID-19 "The Global Financial Safety Net during the COVID-19 Crisis: an Interim Stock-Take." Note: Since the safety net is comprised of different currencies, its USD value fluctuates with exchange rate changes.

### Lessons from the Asian Financial Crisis (4)



#### Strengthening the international financial cooperation

Setting Up the Financial Stability Forum

- In October 1998, the Group of Seven (G7) financial authorities held the first meeting.
- The Financial Stability Forum (FSF) and the Group of Twenty (G20) were set up in February and September 1999, respectively.
- Clearly recognized the need to strengthen **regulatory and supervisory measures** for highly leveraged hedge funds, offshore markets, and short-term capital flows

Group of Twenty (G20)

- The **G20** elevated to **Leaders' summit level** from Finance Ministers/Governors in November 2008.
- Elevated the FSF to the Financial Stability Board (FSB) in April 2009
- Issued principles for cooperation between the IMF and RFAs

The IMF Reforms

- Conducted surveillance reforms (e.g. IMF FSAP 1999 and International Capital Markets Dept 2001)
- Streamlining structural conditionality
- Formalizing cooperation with regional financing arrangements
- Use of capital control

#### Timeline on the Evolution of FSF and G20



1997 Asian Financial Crisis April & Oct 1998
G22 Finance
Ministers & CB
Governors

Meetings held

Mar & Apr 1999
G33 Finance
Ministers & CB
Governors
Meetings held

G20
Finance
Ministers &
CB
Governors
Meeting
launched

Apr 2009
Financial
Stability
Board
(FSB)
elevated
from FSF



















Oct 1998
G7 Finance
Ministers
Meeting
held

Feb 1999
Financial
Stability
Forum
(FSF)
established

Sep 1999 G20 established G20
Leaders'
Summit
elevated
from the
Finance
Ministers &
CB Meeting

## New Risks and Challenges (1)



#### Transitioning to the endemic and boosting structural reforms

- Steering a
  - smooth pandemic exit
- Safeguarding public health remains top priority
- Coping with when and how to exit smoothly from stimulus policies

- Structural reforms and investment to facilitate the transition to a new sustainable, green and digital economy
- Reconfiguring GVCs; adopting technology; strengthening healthcare & social protection; and rebuilding policy space

Rebuilding a more resilient economy Post-pandemic Policy Challenges

Managing sovereign debt and financial risks

- Addressing long-term impact of prolonged stimulus policies
- Managing highly indebted public and private sectors, and possible inflationary pressures

## New Risks and Challenges (2)



The outbreak of the COVID-19 pandemic highlights the need for broadening the AMRO's mandate to cope with structural issues, such as climate change, and growing demand for longer term finance.

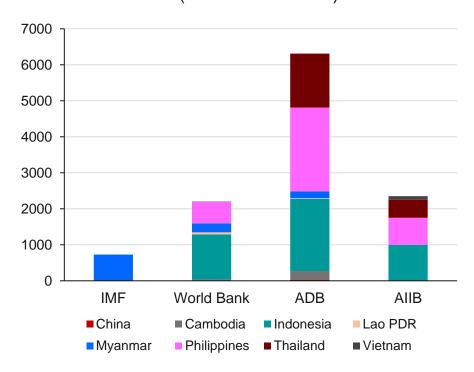
Expanding CMIM toolbox with greater flexibility	<ul> <li>Currently designed to focus solely on BoP and short-term liquidity difficulties</li> <li>Expand lending conditions further in maturity length, or the scope of liquidity crisis</li> <li>Strengthen collaboration with BSAs</li> <li>Reduce IMF-linked portion over time</li> </ul>					
Enhancing AMRO capacity for surveillance and program design	<ul> <li>Enhance functional/sectoral surveillance capacity</li> <li>Expand the scope of surveillance toward more structural issues</li> <li>Build up expertise on program design</li> </ul>					
Seeking complementarities with the IMF	<ul> <li>Seek to play an essential complementary role to the IMF in providing an independent regional perspective and in helping to shape IMF views more even handed</li> <li>Establish own institutional views on key policy issues, reflecting country-specific factors and regional perspectives</li> </ul>					

## New Risks and Challenges (3)



#### Beyond the CMIM: Coping with Longer-term Financing Needs

## Financial Assistance from IMF and MDBs to ASEAN+3 during COVID-19 Pandemic (In millions of USD)



Source: IMF, World Bank, ADB and AIIB websites; AMRO staff calculations (as of 9 September 2020, except for Myanmar as of 6 May 2021; as the calculation method is different in each institution, the validity of the quoted amounts is subject to further confirmation)

#### Growing needs for long-term financing during the pandemic

 Most financing has come from MDBs to assist ASEAN+3 members in development, structural reforms and budget support.

#### CMIM's focus on short-term BoP liquidity crisis

• The current mandate of the CMIM may be too narrow to cover the needs for longer-term financing.

## Exploring alternative ways to support longer-term financing needs in the region

- AMRO to increase capacity to provide TA for low-income countries
- Closer cooperation between the CMIM/AMRO and the ADB
- ASEAN+3 members may consider ramping up the current framework of regional financial cooperation toward strengthening long-term financing support

## Thank you



#### **Contact Us**

**Add**: 10 Shenton Way, #15-08/9, Singapore 079117

**Tel**: +65 6323 9844

Email: khor.hoeee@amro-asia.org

Website: www.amro-asia.org